Franchise Tax Board

SUMMARY ANALYSIS OF AMENDED BILL

Author: Yee and Huffman   Analyst: David Scott   Bill Number: SB 364

Related Bills: See Prior Analysis   Telephone: 845-5806   Amended Date: July 11, 2011

Attorney: Patrick Kusiak   Sponsor:

SUBJECT: Business Tax Incentive Reporting Information and Penalty

SUMMARY

This bill would require taxpayers that claimed a business tax credit to report certain employment information to the Franchise Tax Board (FTB) and would assess a penalty if the taxpayer's California employment levels decreased by more than 10 percent from the prior year.

RECOMMENDATION AND SUPPORTING ARGUMENTS

No position.

SUMMARY OF AMENDMENTS

The July 11, 2011, amendments resolved the department's implementation considerations, technical considerations, and policy concerns. In addition, the July 11, 2011 amendments removed the Sales and Use Tax section from the bill.

The "This Bill" section as provided in the department's analysis of the bill as amended June 14, 2011, has been revised to reflect the amendments discussed above. Because the department's implementation considerations, technical considerations, and policy concerns have been resolved, they are not included in this analysis. The Fiscal Impact discussion has been updated. The remainder of the previous analysis still applies.

Summary of Suggested Amendments

An amendment is suggested to provide appropriation language to fund the departmental costs associated with administering this bill.

ANALYSIS

<u>THIS BILL</u>

This bill would require a taxpayer doing business in the state that claims a business tax credit to annually submit certain employment information to the FTB. The information must be on a timely filed original return and includes the number of full-time equivalent employees, as defined, employed by the taxpayer in the state for the current and prior taxable year.

Board Position:			Asst. Legislative Director	Date
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This bill would assess a penalty of $5,000 (or fractional portion thereof) for each full-time equivalent employee or fractional portion for taxable years beginning on or after January 1, 2012, under the following conditions:

- o The taxpayer has used a business tax credit by an act that takes effect on or after the effective date of the act adding this section, and
- o The taxpayer has a decrease in total California employment of more than 10 percent measured against the prior year, based on the number of full-time equivalent employees.

The penalty would be limited to the amount of business tax credits the taxpayer claimed on their California franchise or income tax returns for the preceding three taxable years. For example, if a taxpayer generated total business tax credits of $30,000 for taxable years 2012 - 2014, and then, in taxable year 2015, had a decrease in total California employment of ten full-time equivalent employees more than 10 percent, then the $50,000 tentative penalty computed on the reduction would be limited to $30,000—the total amount of the business tax credits claimed in the three taxable years immediately prior to the 2015 taxable year.

The three-year look-back period, for purposes of the penalty limitation, would be limited to post-2011 taxable years. In the case of a 2013 taxable year, the penalty would be limited to credits claimed in 2012 and forward, not the full three years the statute specifies.

The bill defines “business tax credit” to mean a credit, based on qualified wages or the number of employees employed, which is available for use against the "net tax" or "tax" due to the state, resulting from an act that is added and takes effect beginning on or after the effective date of this act.

<u>Calculation of the Penalty for Net Decrease in Full-time Employees</u>

The penalty is imposed when there is a greater than 10 percent net decrease in California full-time employee equivalents, as follows:

- Ninety percent of the annual full-time equivalent employees, including any fractional portions, for the preceding taxable year, less
- The total annual full-time equivalent employees, including any fractional portions, for the current taxable year, multiplied by
- Five thousand dollars ($5,000).
- If the computed reduction in annual full-time equivalent employees is zero or less, the penalty is zero.
- If the taxable year being reported is less than a full 12-month period, the full-time equivalents would be annualized to equal 12 month equivalents.

This bill would provide the following definitions:

- "Qualified wages" would mean employee compensation, including but not limited to, wages subject to Division 6 (commencing with Section 13000) of the Unemployment Insurance Code.
- "Full-time equivalent" would mean either of the following:
    - In the case of an employee paid hourly qualified wages, the total number of hours worked for the taxpayer by the employee (not to exceed 1,820 hours per employee) divided by 1,820.
    - In the case of a salaried employee, the total number of weeks worked for the taxpayer by the employee divided by 52.
- "Qualified taxpayer" would mean any person (including any business entity) engaged in or carrying on a trade, business, profession, vocation, calling, or commercial activity in the state and pays qualified wages to more than 100 annual full-time equivalent employees, including the employees of a trade or business acquired during the calendar year.

In addition, the bill would provide that all employees of the trades or businesses that are treated as related under either Section 267, 318, or 707 of the Internal Revenue Code would be treated as employed by a single person.

The bill requires the taxpayer to report the number of annual full-time equivalent employees employed for the preceding and current taxable years on a timely filed original California tax return. If the taxpayer is part of a group of related taxpayers, then if a new taxpayer is acquired or becomes related, the employees of the acquired member are included in both the prior and current year reported full-time employee equivalent. Conversely, if a related party is sold or otherwise becomes unrelated, then the full-time employee equivalents of that party are excluded from the information reported.

If either the current or preceding taxable year is less than a full 12-month period (short period), the full-time employee equivalents for the "short" period will be adjusted to reflect full 12 month equivalents. This would mean annualizing the number of full-time equivalents.[1]

The bill imposes a penalty of $5,000 for a taxpayer's failure to report the information, unless the failure was due to reasonable cause.

[1] For example, a taxpayer has a short period of nine months and computes total FTEs of 180, based on the formula language for hourly and salaried employees. To annualize the 180 FTEs, the taxpayer could divide the 180 by 9 (number of months in the short period), then multiply by 12 (number of months in a normal full taxable year). The result would be 240 FTE's when annualized.

FISCAL IMPACT

Staff estimates a cost of approximately $264,000 in the initial year, with ongoing costs of $23,000 per year, to develop, program, and test revisions to existing systems for this bill. Due to the current fiscal environment and the need for increased resources necessary to implement other pending bills, implementation of this bill is contingent on funding. Accordingly, suggested language is provided in Amendment 1 to fund the department's implementation costs for this bill.

If this bill is enacted without appropriation language, the department will pursue a budget augmentation ("legislative budget change proposal") through the normal budgetary processes, which would delay implementation of the bill's provisions. If approval of a legislative budget change proposal is denied, the department may be unable to implement the provisions of this bill.

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Franchise Tax Board's
Proposed Amendments to SB 364 as amended on July 11, 2011

AMENDMENT 1

On page 8, after line 26, insert:

SEC. 3 The sum of two hundred sixty four thousand dollars ($264,000) is hereby appropriated to the Franchise Tax Board in augmentation of item 1730-001-0001 of the Governor's Budget, Chapter 33, Statutes of 2011. Implementation of the reporting requirements by section 3 of this bill is contingent upon receipt of an appropriation.